

## Saving Family Farms from Eliminated Step-Up in Basis

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# **Saving Family Farms from Eliminated Step-Up in Basis**

SYDNEY BURCKART\*

## ABSTRACT

To achieve tax equality, lawmakers have proposed eliminating the step-up in basis for assets passing through an estate at death. Closing the loophole would indeed tax the rich, but it would also impact middle-class Americans, including full-time farmers. Farmers would incur large tax liability, inhibiting their ability to earn a living exclusively on the farm. Eliminating step-up in basis is a volatile issue that lawmakers have considered implementing to achieve tax equality. This article will present the history of the step-up in basis debate and analyze past efforts to close the step-up in basis loophole. That history informs recent tax amendment propositions and their problematic effect on full-time farmers. Finally, the article proposes alternatives and protections for full-time farmers so that the agricultural community will not be adversely affected by a measure intended to achieve tax equality.

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No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 171

## I. INTRODUCTION

“I’m sick and tired of the super-wealthy and giant corporations not paying their fair share in taxes.”<sup>1</sup> This tweet from President Joe Biden on September 22, 2021, is an echo of the progressive battle cry for tax reform.<sup>2</sup> “Tax the Rich” is not a new ideology, and neither are tax reforms proposed to achieve tax equality.<sup>3</sup> One provision in the progressive crosshairs is the step-up in basis, which adjusts the basis of assets passed through an estate, trust, or beneficiary designation to the current fair market value of that asset instead of the asset’s original purchase price.<sup>4</sup> Policymakers have strong opinions about the step-up in basis, with some calling it a loophole that must be removed and others defending it as a valuable provision that boosts economic growth.<sup>5</sup>

One group advocating for the preservation of the step-up in basis comes from America’s heartland: farmers.<sup>6</sup> The step-up in basis has been a valuable provision for farmers because while they own high-value assets like land and equipment, they often realize modest income from their operations.<sup>7</sup> Policymakers from both sides of the aisle recognize that the step-up in basis should be preserved for small businesses like family farms, but protecting these middle-class Americans from being swept into a tax reform meant for the most wealthy is easier said than done.<sup>8</sup> This article will explain the step-up in basis provision, address the history of the step-up in basis controversy, analyze past efforts to eliminate the step-up in basis provision, explain current tax amendment propositions and their effect on full-time farmers, and propose options for eliminating the step-up in basis so that farmers are protected from exorbitant tax liability.

## II. WHAT IS THE STEP-UP IN BASIS?

Step-up in basis is a tax provision that resets the basis of an asset passed from a decedent to an heir or devisee through an estate to the current fair market value of that asset.<sup>9</sup> When a buyer purchases an asset, the cost of that asset is called the

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1. President Biden (@POTUS), TWITTER, <https://twitter.com/POTUS/status/1440794506652110848> (last visited Nov. 6, 2021); See Jim Tankersley, *In Push to Tax the Rich, White House Spotlights Billionaires’ Tax Rates*, N.Y. TIMES (Sep. 23, 2021), <https://www.nytimes.com/2021/09/23/us/politics/biden-wealthy-tax-rates.html>.

2. Tankersley, *supra* note 1.

3. See Monica Prasad, *Actually, It Was Democrats Who Killed The 70 Percent Tax*, POLITICO (Feb. 5, 2019), <https://www.politico.com/agenda/story/2019/02/05/democrats-70-percent-tax-rate-000879/>.

4. See 26 U.S.C. § 1014.

5. See Republican, Democratic Lawmakers Unite With Farmers on Stepped-Up Basis, FARM BUREAU (Sept. 2, 2021), <https://www.fb.org/news/republican-democratic-lawmakers-unite-with-farmers-on-stepped-up-basis>.

6. See Chuck Abbott, *To Tax Wealth, Biden Would Narrow ‘Stepped-Up Basis Loophole*, SUCCESSFUL FARMING (Apr. 29, 2021), <https://www.agriculture.com/news/business/to-tax-wealth-biden-would-narrow-stepped-up-basis-loophole>.

7. *Id.*

8. Zachary Halaschak, *Democrats Face Internal Disagreement Over Biden Plan to Tax Large Inheritances*, WASH. EXAM’R (Sept. 2, 2021), <https://www.washingtonexaminer.com/news/democrats-internal-disagreement-stepped-up-basis-biden-plan>; Taylor Tepper, *Stepped Up Basis Reform: Biden’s Middle Class Tax Hike?* FORBES ADVISOR (May 7, 2021, 10:10 AM), <https://www.forbes.com/advisor/investing/stepped-up-basis-biden-tax-plan/>.

9. 26 U.S.C. § 1014(a)(1).

“basis,” and when the buyer sells the asset at a higher price, she must pay tax on the difference between the original cost and the appreciated sale price, or the capital gains.<sup>10</sup> For example, if Tom purchases an asset like farmland for 400,000 dollars, his basis is 400,000 dollars.<sup>11</sup> If Tom sold the farmland for one million dollars, he would pay taxes on the capital gain of 600,000 dollars.<sup>12</sup> However, if Tom farmed the land for his entire life and then passed the land to his son, Rick, through his estate at his death, Rick’s tax liability would be different due to step-up in basis. Instead, since the farmland was passed to Rick at Tom’s death, Rick receives a step-up in basis to the current fair market value of the farmland.<sup>13</sup> If, when Rick inherited the farmland, it was worth one million dollars, Rick could immediately sell the farmland for one million dollars without incurring any capital gains tax liability.<sup>14</sup> For this reason, Bazikyan Law Group calls step-up in basis the “best and biggest tax break the IRS code allows.”<sup>15</sup>

Step-up in basis has long been a valuable estate planning tool, particularly for farmers. Agriculture is a difficult industry to enter because high land prices are a significant barrier to entry.<sup>16</sup> Additionally, full-time farmers struggle to make a living from agriculture alone.<sup>17</sup> Though food prices have increased, commodities prices have plummeted, so farmers make less money on every unit they produce.<sup>18</sup> Between 2013 and 2018, farm income dropped 50%, and that was before the ravages of the COVID-19 pandemic.<sup>19</sup> Furthermore, the high capital investment necessary to start farming is another barrier for new farmers.<sup>20</sup> Farming journalist and landowner Shawn Williamson made a conservative estimate that first-generation farmers would need to invest over five million dollars in start-up costs just to make a living as a full-time farmer.<sup>21</sup> Other farmers argue that estimate should be much higher.<sup>22</sup>

In the United States, agriculture is traditionally a familial occupation, with farm assets passing from one generation to the next so that the family business can continue.<sup>23</sup> When successors want to “come back to the farm,” the step-up in basis allows older farmers to pass business assets to their successors, which lightens the

10. Topic No. 409, IRS (last visited Nov. 8, 2021, 8:39 pm), <https://www.irs.gov/taxtopics/tc409>.

11. *Why Is Step Up In Basis So Important?* BAZIKYAN LAW GROUP (June 7, 2018), <https://bazikyan-law.com/step-up-in-basis/>.

12. *See id.*

13. *See id.*

14. *See id.*

15. *Id.*

16. Kelly Robinson-Thompson, *Exploring Barriers to Entry to Agriculture: Challenges Facing Beginning Farmers in North Carolina*, (Apr. 2019), (Masters Thesis, Duke University) (on file at Duke University Library).

17. *Understanding the Economic Crisis Family Farms Are Facing*, FARMAID.ORG (Sept. 14, 2020), <https://www.farmaid.org/blog/fact-sheet/understanding-economic-crisis-family-farms-are-facing/>.

18. *Id.*

19. *Id.*

20. Shawn Williamson, *How Much \$ Does It Take to Become A Farmer?* SUCCESSFUL FARMING (June 6, 2017), <https://www.agriculture.com/farm-management/business-planning/how-much-does-it-take-to-become-a-farmer>. (calculating based on a grain farmer in Iowa, Illinois, or Indiana farming 1,500 acres of land and investing in exclusively used machinery that is five to ten years old).

21. *Id.*

22. Interview by Sydney Burckart with Rick Luttrull, Head Farmer, R&M Farms, Inc., in Lewistown, MO. (Nov. 6, 2021); Interview by Sydney Burckart with Trevor Jaco, Associate Farmer, R&M Farms, Inc., in Lewistown, MO. (Nov. 6, 2021).

23. *Multigenerational Farming: Why It Works*, AGRILEGACY (last visited Nov. 15, 2021, 9:30 AM), <https://agrilegacy.com/multigenerational-farming-why-it-works/>.

No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 173

burden of start-up costs. In addition, the population of farmers is aging, so many farm assets will be transferred to farming successors in the coming years.<sup>24</sup> Preserving the step-up in basis for farmers is as important as ever.

Of course, agriculture is not the only area where step-up in basis saves taxpayers a lot of money. Any appreciated asset gets a step-up in basis when it is passed to a beneficiary at the death of the original owner.<sup>25</sup> For farmers, the greatest benefit comes from a step-up in basis on farmland that has appreciated exponentially over the last generation.<sup>26</sup> Average Americans might receive a step-up in basis on an inherited family home, vacation home, or stock investments. For top earners, step-up in basis means passing vast investment fortunes at their death to their heirs and escaping millions of dollars in capital gains taxes.<sup>27</sup> That is the loophole that lawmakers want to close – the vast fortunes that create generational dynasties amassing wealth at the very top. Even though the step-up in basis is helpful to family businesses and full-time farmers, it has been criticized by tax reformers as a loophole for the ultra-wealthy that must be closed.<sup>28</sup>

### III. THE HISTORY OF THE STEP-UP IN BASIS CONTROVERSY

Eliminating step-up in basis has been proposed multiple times in the past 50 years as a mechanism for redistributing tax liability from the American middle class to the wealthiest taxpayers.<sup>29</sup> The first time was in 1976 with the Tax Reform Act, which replaced the step-up in basis with a carryover basis system.<sup>30</sup> At that time, critics of the step-up in basis voiced many of the same complaints that are common today – that the step-up in basis created a major loss in tax revenue, and that it was a provision solely enjoyed by the extremely wealthy.<sup>31</sup> But when lawmakers suggested repealing the provision, backlash erupted from farmers and small business owners who argued that the greatest burden would fall on them.<sup>32</sup> Bankers and attorneys worried that the provision would create a “nightmare of paperwork” as they sought to establish the original value of long-held assets by sorting through old records that were incomplete or non-existent.<sup>33</sup> In response, the bill was retroactively repealed in 1980 and never reinstated.<sup>34</sup>

24. Robinson-Thompson, *supra* note 16, at 9-10 (explaining that most farmland is held by farms aged 65 and older, and farmers under 35 only account for 6% of the population, which suggests that young farmers choose to go to college and work off-farm jobs before they launch into farming).

25. Topic No. 409, *supra* note 10. This is not limited to a formal probate estate but also includes post-death gifts, beneficiary deeds, and revocable trusts.

26. See discussion *infra* Section III(A).

27. Chuck Marr, Samantha Jacoby, & Kathleen Bryant, *Substantial Income of Wealthy Households Escapes Annual Taxation Or Enjoys Special Tax Breaks*, CENTER ON BUDGET AND POLICY PRIORITIES (Nov. 13, 2019), <https://www.cbpp.org/research/federal-tax/substantial-income-of-wealthy-households-escapes-annual-taxation-or-enjoys>.

28. *Id.*

29. Lincoln Flemming, *Repeal of Basis Step-Up: Third Time's the Charm?*, APERIO (June 29, 2021), <https://www.aperiogroup.com/blogs/repeal-of-basis-step-up-third-times-the-charm>.

30. *Id.*

31. John Kartch, *NYT in 1979: Elimination of Stepped Up Basis is “A Nightmare of Paperwork” and “Impossibly Unworkable,”* AMERICANS FOR TAX REFORM (Mar. 29, 2021), <https://www.atr.org/nyt-1979-elimination-stepped-basis-nightmare-paperwork-and-impossibly-unworkable>; Frederick Andrews, *Rethinking Inheritance*, N.Y. TIMES July 3, 1979, at D2.

32. Andrews, *supra* note 31.

33. *Id.*

34. *Id.*

Congress tried again in 2001 with the Economic Growth and Tax Relief Reconciliation Act.<sup>35</sup> This law eliminated the estate tax, which taxed estate values exceeding the estate tax exemption of five million dollars, and replaced the step-up in basis with a carry-over basis for the 2010 tax year only.<sup>36</sup> Carry-over basis means beneficiaries that inherit an asset through an estate receive the same basis as the original owner, so if they ever sell the asset, they will be taxed on the capital gains of the original owner as well as their own gains.<sup>37</sup> The change was short-lived.<sup>38</sup> Once again, Congress retroactively reinstated the estate tax and step-up in basis for decedents in 2010 while allowing estate administrators to choose between the estate tax with carryover basis or no estate tax with a step-up in basis depending on their financial situation.<sup>39</sup>

Former President Barack Obama also targeted the step-up in basis provision as a focal point of tax reforms to fight inequality.<sup>40</sup> He desired to use the tax revenue generated from eliminating this provision to fund social programs for the lower and middle classes.<sup>41</sup> In addition, President Obama proposed a capital gains tax rate increase from 20% to 28%.<sup>42</sup> However, he did not have the support in Congress to make these changes a reality during his administration.<sup>43</sup> Despite the history of turmoil surrounding the step-up in basis, lawmakers are committed to its repeal in the current administration.<sup>44</sup>

### A. *Proposals to Eliminate the Step-up in Basis*

Eliminating the step-up in basis was back on the tax reform table when President Biden's administration began in 2020, and progressive policymakers proposed various plans to achieve its repeal. On March 25, 2021, Senator Bernie Sanders introduced the For the 99.5 Percent Act, a tax amendment plan that would drastically change estate and gift taxes and eliminate step-up in basis.<sup>45</sup> The draft contained changes like cutting the estate tax exemption amount from 11.7 million dollars to 3.5 million dollars and raising the estate tax rate proportionally to estate

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35. Flemming, *supra* note 29.

36. *Id.*; *Federal Estate and Gifts Tax Rates, Exemptions, and Exclusions, 1916-2014*, TAX FOUNDATION (Feb. 4, 2014), <https://taxfoundation.org/federal-estate-and-gift-tax-rates-exemptions-and-exclusions-1916-2014/>.

37. *Carryover Basis*, LEGAL INFORMATION INSTITUTE: CORNELL UNIVERSITY (last visited Nov. 15, 2021, 9:47 AM), [https://www.law.cornell.edu/wex/carryover\\_basis](https://www.law.cornell.edu/wex/carryover_basis).

38. *Id.*

39. Flemming, *supra* note 29.

40. Jared Bernstein, *Here's One Way to Fight Inequality: President Obama Goes After A Big, High-End Loophole and Uses The Revenues to Help The Middle Class*, WASH. POST (Jan. 17, 2015), <https://www.washingtonpost.com/posteverything/wp/2015/01/17/heres-one-way-you-fight-inequality-president-obama-goes-after-a-big-high-end-loophole-and-uses-the-revenues-to-help-the-middle-class/>.

41. *Id.*

42. *Id.*

43. *Id.*

44. *What is the Stepped-Up Basis, and Why Does the Biden Administration Want to Eliminate It?*, PETER G. PETERSON FOUNDATION (June 21, 2021), <https://www.pgpf.org/blog/2021/06/what-is-the-stepped-up-basis-and-why-does-the-biden-administration-want-to-eliminate-it>.

45. Matthew Erskine, *For the 99.5 Percent Act – What It Is, What It Does and What To Do About It*, FORBES (Apr. 2, 2021), <https://www.forbes.com/sites/matthewerskine/2021/04/02/for-the-995-p...actwhat-it-is-what-it-does-and-what-to-do-about-it/?sh=61e7083b2e73>.

No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 175

size.<sup>46</sup> In addition, Sanders proposed increasing the gift tax rate, eliminating step-up in basis for assets in an Intentionally Defective Irrevocable Grantor Trust (IDIGT), and changing the valuation for assets passed through an estate.<sup>47</sup> Forbes analyst Matthew Erskine concluded that these changes would only affect those with assets valued at over seven million dollars.<sup>48</sup>

Several Democratic senators introduced the Sensible Taxation and Equity Promotion (“STEP”) Act.<sup>49</sup> In a fact sheet published by Senator Chris Van Hollen from Maryland, the proposed solution to the “wealthiest family dynasties” avoiding taxation is to eliminate the step-up in basis provision.<sup>50</sup> The STEP Act also included special rules to seal the gaps wealthy Americans try to exploit – preventing them from skirting new taxes through creative estate planning methods.<sup>51</sup> For example, the death of the original owner would be treated as if the original owner had sold the asset in the last year of his life (also called a “realization event”) so that beneficiaries would incur capital gains tax liability on any appreciated asset even if they did not sell it.<sup>52</sup> At the same time, the plan tries to protect small businesses, including family farms, by excluding the first one million dollars from the hefty tax rates and allowing taxpayers to pay the capital gains tax on farm assets over a 15-year period.<sup>53</sup>

President Joe Biden also introduced a tax reform plan to raise money for his Build Back Better initiative.<sup>54</sup> His focus was to “reverse a recent tax cut for the highest income taxpayers... while increasing the progressivity of the tax system.”<sup>55</sup> Some of these progressive measures included taxing capital gains income over one million dollars at 39.6% instead of 20%, eliminating the step-up in basis, and treating the transfer of property by gift or at death as a “realization event.”<sup>56</sup> The plan also assured protections for family farms and businesses that are passed to familial

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46. *Id.* (listing current tax law lists exemptions at 10 million dollars adjusted for inflation each year, so the number in 2021 was 11.7 million dollars).

47. *Id.*

48. *Id.*; *Income and Wealth in Context*, USDA ECON. RSCH. SERV., (Feb. 4, 2022), <https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/farm-business-income/> (stating that the average farm household net worth was \$1,714,599 in 2020).

49. *Van Hollen Leads Colleagues in Announcing New Legislation to Close The Stepped-Up Basis Loophole*, CHRIS VAN HOLLEN (Mar. 29, 2021), <https://www.vanhollen.senate.gov/news/press-releases/van-hollen-leads-colleagues-in-announcing-new-legislation-to-close-the-stepped-up-basis-loop-hole>; SENSIBLE TAXATION AND EQUITY PROMOTION (STEP) ACT, <https://www.vanhollen.senate.gov/imo/media/doc/One%20pager%20-%20STEP%20Act.pdf> (last visited Feb. 17, 2022) (hereinafter STEP Act Fact Sheet).

50. STEP Act Fact Sheet, *supra* note 49.

51. *Id.*

52. *Tax Treatment of Capital Gains at Death*, CONG. RSCH. SERV. (last updated June 4, 2021), <https://crsreports.congress.gov/product/pdf/IF/IF11812>.

53. *Id.*; STEP Act Fact Sheet, *supra* note 49.

54. *FACT SHEET: President Biden’s Build Back Better Agenda Will Deliver Historic Investments in American Families and Communities*, WHITE HOUSE (Aug. 13, 2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/08/13/fact-sheet-president-bidens-build-back-better-agenda-will-deliver-historic-investments-in-american-families-and-communities/> (hereinafter White House Fact Sheet).

55. *General Explanations of the Administration’s Fiscal Year 2022 Revenue Proposals*, DEP’T OF THE TREAS. (May 2021), <https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf>.

56. *Id.* at 62.

heirs from these tax burdens intended only for the wealthiest Americans.<sup>57</sup> For example, farmers will be able to defer any tax liability so long as the farm remains owned and operated by the family.<sup>58</sup> Also, any tax liability incurred could be paid over a 15-year period.<sup>59</sup>

### B. *Division and Debate Concerning Eliminating Step-up in Basis*

The agricultural community criticized the plans because the potential tax liability for full-time family farmers would quickly exceed the carveouts intended to shield them. Critics wondered if the provisions meant to target only the ultra-wealthy, such as those with assets exceeding 30 million dollars, would turn into a middle-class tax hike.<sup>60</sup> But advocates of President Biden's plan argued that provisions like the one million dollar carveout would be enough to shield family farms and small businesses from crippling tax liability.<sup>61</sup> As soon as step-up in basis showed up on the chopping block of many tax reforms, farmers worried that they would be forced to sell significant portions of their land and equipment just to pay the taxes incurred by passing the farm from one generation to the next. Representative Tom Emmer from Minnesota criticized the plans saying,

Family farms play a critical role in the way we feed, fuel, and clothe our country. Increasing the capital gains tax, eliminating stepped-up basis, and adding another tax at the time of death takes money that should be reinvested in the next generation of farmers and instead sends it to Washington's coffers.<sup>62</sup>

Even though eliminating step-up in basis is a politically progressive policy, many Democratic lawmakers opposed the measure as well.<sup>63</sup> In a letter to the Biden Administration addressing their concerns about eliminating the step-up in basis, Democratic lawmakers said,

While the clear intention of making changes to stepped-up basis is to ensure vast fortunes worth tens or even hundreds of billions are not passed

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57. *FACT SHEET: The American Families Plan*, The White House (Apr. 28, 2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/>.

58. Matthew Erksine, *The New Biden Green Book: Tax Law Changes And Unintended Consequences*, FORBES (June 18, 2021, 2:57 PM), <https://www.forbes.com/sites/matthewerskine/2021/06/18/the-new-biden-green-book-tax-law-changes-and-unintended-consequences/?sh=75fcbd08936d>.

59. *Id.*

60. See Taylor Tepper, *Stepped Up Basis Reform: Biden's Middle Class Tax Hike?*, FORBES ADVISOR (May 7, 2021) <https://www.forbes.com/advisor/investing/stepped-up-basis-biden-tax-plan/>.

61. Nick Buffie & Bob Lord, *American Families Plan Taxes Billionaires and Protects Family Farms and Businesses*, CENTER FOR AMERICAN PROGRESS (Aug. 30, 2021, 12:01 AM), <https://www.americanprogress.org/issues/economy/reports/2021/08/30/503225/american-families-plan-taxes-billionaires-protecting-family-farms-businesses/>.

62. *Emmer Urges Biden Administration to Protect Family Farms from Capital Gains Increases*, TOM EMER (Apr. 8, 2021), <https://emmer.house.gov/2021/4/emmer-urges-biden-administration-to-protect-family-farms-from-capital-gains-increases>.

63. See Halaschak, *supra* note 8.



No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 177

on without any income tax paid at any point, we are concerned about the unintended burden this could place on farms and family businesses.<sup>64</sup>

Congressman Max Baucus, who served in Washington during previous attempts to eliminate the provisions, said, “[l]awmakers should know this is a mistake.”<sup>65</sup> His greatest concerns included the possibility that family farms could be forced to liquidate business assets like farmland at the death of a family member just to keep the farm alive.<sup>66</sup> Additionally, lawmakers were concerned about provisions in each plan that would make the changes retroactive to 2021, meaning taxpayers would have no time to plan for the drastic changes that could severely damage their ability to continue farming.<sup>67</sup>

In September 2021, the Senate Finance Committee proposed plans that softened the measures of other Democrats and the President. The Senate plan included more carveouts to ensure middle-class family farmers and small business owners would not be swept into the tax hikes.<sup>68</sup> The new proposal would increase the capital gains tax rate to be similar to ordinary income.<sup>69</sup> Capital gains of the highest earners would be taxed at 39.6%, while lower earners would match their capital gains rate to their income tax rate.<sup>70</sup> Step-up in basis would be eliminated, and the death of an owner would be a realization event triggering tax liability.<sup>71</sup> But the new proposal tempers other proposals by allowing larger carve-out exemptions, including five million dollars for individuals and 10 million dollars for a couple.<sup>72</sup> In addition, farmers will enjoy a 25-million-dollar exemption for family farm businesses.<sup>73</sup>

With so many differing opinions on the effects of the step-up in basis, it is unlikely that amendments to the current tax laws will include all the problematic measures proposed by some lawmakers.<sup>74</sup> It looks like the step-up in basis may live to fight another day.

#### IV. THE PROBLEM WITH ELIMINATING STEP-UP IN BASIS FOR FARMERS

Lawmakers recognize that eliminating the step-up in basis could hurt family farms, but they underestimate the effects the measure could have on full-time farmers. The Biden Administration has stressed that small businesses and farms will not be impacted by a step-up in basis if the farm assets “stay in the family.”<sup>75</sup> The United

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64. *Id.*; Chris Clayton, *Debate Heats Up Over Step-Up in Basis*, PROGRESSIVE FARMER (May 6, 2021, 4:17 PM) <https://www.dtnpf.com/agriculture/web/ag/news/business-inputs/article/2021/05/06/rural-democrats-seek-bill-language>.

65. Halaschak, *supra* note 8.

66. *Id.*

67. *See* Erkshine, *supra* note 58.

68. *See* Buffie & Lord, *supra* note 61.

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *See generally id.*; *see* Halaschak, *supra* note 8

75. White House Fact Sheet, *supra* note 54; *The American Families Plan Honors America’s Family Farms*, USDA (Apr. 28, 2021), <https://www.usda.gov/media/press-releases/2021/04/28/american-families-plan-honors-americas-family-farms> (hereinafter USDA).

States Department of Agriculture (USDA) estimated that “more than 98% of farm estates will not owe any tax at transfer, provided the farm stays in the family.”<sup>76</sup> One proponent called opposition to these plans “absurd attempts by powerful interests to pretend they are defending the little guy.”<sup>77</sup> According to a USDA press release, Biden’s tax plan protects small businesses and family farms in two ways. First, no tax will be due for farm assets if those assets stay in the family.<sup>78</sup> Second, the first one million dollars of capital gains, or two million dollars for couples, will be exempt from any capital gains tax.<sup>79</sup> These protective reforms are designed to “reward work and not wealth.”<sup>80</sup> Advocates of the tax proposals hang their hats on these carve-outs and exemptions to deter the impact of an elimination in step-up in basis.<sup>81</sup> Despite attempts to protect America’s heartland, these exemptions would not be enough to truly protect full-time farmers.

### A. *The Economic Impact of Eliminating Step-up in Basis for Full-time Farmers*

Eliminating the step-up in basis alone would be harmful to full-time farmers; but eliminating that provision while simultaneously increasing the capital gains tax rate and decreasing the estate tax exemption creates “triple whammies” for farmers.<sup>82</sup> Democratic tax plans propose all those changes. To measure the economic impact of these changes, Texas A&M conducted a study on the effect of the For the 99.5 Percent Act and the STEP Act on generational transfers of farm assets.<sup>83</sup> The study used 94 representative farms across 30 states to measure the effect of the policies on full-time farmers.<sup>84</sup> This same model of representative farms has been used for over 30 years to gauge the effect of public policy changes on farms across the United States.<sup>85</sup> The study analyzed cash balances through 2026 under five scenarios: (1) current tax law with no generational transfer, (2) current tax law with a generational transfer, (3) the STEP Act with a generational transfer, (4) the For the 99.5 Percent Act with a generational transfer, and (5) both the STEP Act and the For the 99.5 Percent Act with a generational transfer.<sup>86</sup> The results were startling.

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76. USDA, *supra* note 75.

77. Steve Warmhoff, *Opposition to Biden’s Tax Plan Has Nothing to Do with Small Businesses or Family Farms*, INSTITUTE ON TAXATION AND ECONOMIC POLICY (July 15, 2021), <https://itep.org/opposition-to-bidens-tax-plan-has-nothing-to-do-with-small-businesses-or-family-farms/>.

78. USDA, *supra* note 75.

79. *Id.*

80. *Id.*

81. *See id.*

82. Myron Friesen, *Hurry Up and Wait For Answers on Policies That Could Impact Farm Estate Plans*, AGWEEK (Jan. 24, 2021, 4:30 AM), <https://www.agweek.com/opinion/columns/6849307-Hurry-up-and-wait-for-answers-on-policies-that-could-impact-farm-estate-plans>.

83. JOE L. OUTLAW ET AL., TEXAS A&M, AGRIC. AND FOOD POL’Y CTR., ECONOMIC IMPACTS OF THE SENSIBLE TAXATION AND EQUITY PROMOTION ACT AND FOR THE 99.5 PERCENT ACT ON AFPC’S REPRESENTATIVE FARMS AND RANCHES 3 (2021).

84. *Id.*

85. *Id.* at 7.

86. Outlaw et al., *supra* note 83, at 15 (pointing to the findings of this study to critique President Biden’s tax plan. However, this study does not measure the effects of the Build Back Better Plan. While the STEP Act and for the 99.5 Percent Act include more aggressive tax reforms than President Biden’s plan, several provisions, including elimination of the step up in basis, are consistent across the three proposals).

No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 179

In the first scenario, which reflects current tax law with no generational transfer, 38 farms reported a negative cash balance at the end of 2026.<sup>87</sup> “[E]ven in the status quo scenario, there are farms struggling to cash flow across all types of farms and ranches.”<sup>88</sup> In the second scenario, where current tax law is maintained, but there is a generational transfer, there is a sharp contrast between generational transfers under current law and under the new proposals.<sup>89</sup> In the third scenario, where the current estate tax remains intact but step-up in basis is eliminated, 92 farms incurred additional tax liability averaging over 700,000 dollars despite the one-million-dollar exemption.<sup>90</sup> In the fourth scenario, where the estate tax exemption is lowered but step-up in basis remains in effect, only 41 farms were impacted, but their average additional tax liability was over one million dollars per farm.<sup>91</sup> In the fifth scenario, with provisions of both plans implemented, meaning the estate tax exemption is lowered and step-up in basis is eliminated, 92 of the 94 farms were impacted.<sup>92</sup> The average additional tax liability was 1.43 million dollars per farm.<sup>93</sup> Additionally, farms averaged a negative cash balance at the end of 2026 in every single scenario.<sup>94</sup>

Another study by Ernst and Young (“EY”) estimated the impact of new tax proposals on the U.S. economy as well as family-owned businesses.<sup>95</sup> EY assessed the impact of capital gains taxes due at death with a repeal of the step-up in basis on a family-owned cow-calf farm.<sup>96</sup> Under the circumstances laid out in the study, the capital gains tax would trigger 2.8 million dollars in liability, or 280% of the farm’s annual income.<sup>97</sup> This model assumed the capital gains tax rate remains at 20% even though new proposals suggest raising the rate as high as 39%.<sup>98</sup>

The Center for American Progress reviewed these studies, and the critiques from that review have been cited by many to dismiss the concerns that farmers have about the new policies.<sup>99</sup> They point to the one to two-million-dollar carve-out exemptions from any estate tax liability as the saving grace that isolates the economic brunt of the changes to “very few people.”<sup>100</sup> They specifically targeted the Texas A&M and EY studies because “the novelty of their conclusions...greatly exceeds the strength of their evidence.”<sup>101</sup> A key argument of the critique said that the 94 representative farms used to measure public policy changes of the agricultural community do not actually represent average American farms.<sup>102</sup> The study uses full-

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87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* at 16.

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.* at 17.

95. *Repealing Step-Up of Basis on Inherited Assets; Macro-Economic Impacts and Effects on Illustrative Family Businesses*, ERNST & YOUNG (Apr. 2021), [https://www.fb.org/files/FBETC\\_Stepped-Up\\_Basis\\_Report\\_2021](https://www.fb.org/files/FBETC_Stepped-Up_Basis_Report_2021).

96. *Id.* at 10.

97. *Id.*

98. *Id.*

99. Buffie & Lord, *supra* note 61.

100. *Id.*

101. *Id.*

102. *Id.*

time, commercial-scale family operations, which only account for 8.2% of family farms in America.<sup>103</sup> The other 91.8% are noncommercial farmers.<sup>104</sup>

That assertion is correct. However, the study accurately represents the sect of American agriculture that the nation relies on for major production. The definition of a farm, according to the 2017 Agriculture census, is “any place from which 1,000 dollars or more of agricultural products were produced and sold, or normally would have been sold, during the census year.”<sup>105</sup> Under this definition, a hobby gardener selling produce at an expensive farmers market could fall under the definition of a farm if she reached 1,000 dollars in sales over an entire year. A USDA study on small acreage farming also reported that 41% of farms with 10 acres of land or less reported income over 1,000 dollars in 2007.<sup>106</sup> Nearly 300,000 farms in the U.S. are between one and nine acres in size.<sup>107</sup> In addition, 51.1% of farms were reporting economic sales of less than 10,000 dollars.<sup>108</sup> These statistics indicate that most farmers in America do not rely on their farming operations as their sole source of income. “America is a nation of part-time farmers.”<sup>109</sup> Additionally, many farmers, including full-time and part-time farmers, operate on losses or minimal profits.<sup>110</sup>

However, farmers that do use their operations as the sole source of income for their families will suffer greatly. While only 32% of family farms in America would exceed the threshold designed to protect family farms, 91% of American farmland is owned by that 32%.<sup>111</sup> These are the farmers represented in the Texas A&M and EY studies. If step-up in basis is eliminated, the farmers that produce the bulk of American food and commodities will suffer significant economic losses.

### B. Skyrocketing Farmland Prices Require Farmers to be Asset Rich and Cash Poor.

Farmland, much like other assets, has appreciated exponentially in recent years.<sup>112</sup> Even though farming is an asset-rich industry, most farmers and ranchers struggle with cash flow and low-profit margins.<sup>113</sup> Farmland values have increased by an average of 223% across the country, and over 300% in some midwestern

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103. *Id.*

104. *Id.*

105. 2017 *Census of Agriculture*, USDA NAT’L AGRI. STAT. SERV. (Apr. 2019), [https://www.nass.usda.gov/Publications/AgCensus/2017/Full\\_Report/Volume\\_1\\_Chapter\\_1\\_US/usv1.pdf](https://www.nass.usda.gov/Publications/AgCensus/2017/Full_Report/Volume_1_Chapter_1_US/usv1.pdf).

106. Doris J. Newton, *Working the Land With 10 Acres: Small Acreage Farming in the United States*, USDA (Apr. 2014).

107. 2017 *Census of Agriculture*, *supra* note 105, at 3.

108. USDA, *Farms and Land in Farms 2019 Summary*, at 5 (Feb. 2020), [https://www.nass.usda.gov/Publications/Todays\\_Reports/reports/fnl00220.pdf](https://www.nass.usda.gov/Publications/Todays_Reports/reports/fnl00220.pdf).

109. Ivory Harlow, *From Boardroom to Barnyard: Why Most American Farmers Farm Part-Time*, FARM AND DAIRY (Mar. 24, 2017), <https://www.farmanddairy.com/top-stories/from-boardroom-to-barnyard-why-the-majority-of-american-farmers-farm-part-time/404831.html>.

110. *Id.*

111. Newton, *supra* note 106; Jerry Hagstrom, *American Farm Bureau: Biden Tax Plan Would Raise Taxes on Farms and Ranches*, *Progressive Farmer* (Apr. 30, 2021), <https://www.dtnpf.com/agriculture/web/ag/blogs/ag-policy-blog/blog-post/2021/04/30/american-farm-bureau-biden-tax-plan>.

112. *Elimination of Stepped-Up Basis Poses Hazards to Family Farms*, AM. FARM BUREAU FED’N (Apr. 7, 2021), <https://www.fb.org/market-intel/elimination-of-stepped-up-basis-poses-hazards-to-family-farms>.

113. *Id.*

No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 181

states, since 1997.<sup>114</sup> Upon sale of this appreciated land with a capital gains tax rate of 20%, American farmers would incur an average tax liability of 560 dollars per acre, with farmers in some states reaching tax liability of over 1,000 dollars per acre.<sup>115</sup> So a farmer owning 1,500 acres, the minimum number of acres a farmer must own to make a living as a full-time farmer, with an average capital gain of 560 dollars per acre, would incur a tax liability of 840,000 dollars.<sup>116</sup>

If the tax law was amended to increase the capital gains tax rate to 39%, with death being treated as a “realization event” for heirs of an estate, tax liability would rise.<sup>117</sup> For example, a farmer inherits farmland from his parents, which they purchased in 1997 for 1,270 dollars per acre. The land has appreciated in value by 223% and is currently worth roughly 2,830 dollars per acre. The difference of 1,560 taxed at a capital gains rate of 39% means the farmer would incur 608.40 dollars per acre in tax liability even if he never sells the farmland but continues to use it for his own farming operation. Additionally, that farmer would only have to own around 1,650 acres of land before exceeding the one-million-dollar exemption. Since many farms, especially full-time farms, are generational operations, it is likely that much of the farmland has been in the family for longer than 25 years, making such tax liability even higher.

Farmers who rely on their farming business as their sole source of income would quickly exceed the one-million-dollar exemption proposed to protect them from crippling tax liability triggered by eliminating the step-up in basis and making the death of the original owner a realization event. Since farmers are cash-poor, the value of their business is wrapped up in non-liquid assets like equipment, vehicles, buildings, grain storage, animals, and farmland. But farmers cannot pay taxes with combines, grain bins, or cows, so they would liquidate assets to pay taxes. Therefore, farmers have cried that they would have to “sell the farm to pay taxes.”

### *C. Vague Exemptions Do Not Actually Protect Full-time Farmers.*

Lawmakers on both sides of the aisle recognize that eliminating step-up in basis without exceptions for farmers would be catastrophic to the agriculture industry, but broad exemptions leave many questions unanswered. According to the White House Fact Sheet addressing the proposals, “[t]he reform will be designed with protections so that family-owned businesses and farms will not have to pay taxes when given to heirs who continue to run the business.”<sup>118</sup> The USDA also ensures that the reform “won’t affect family farms that stay in the family.”<sup>119</sup> Proponents of the plan say, “the proposal includes special protections for owners of family farms and businesses who plan to keep their enterprises in the family.”<sup>120</sup> Lawmakers understand the necessity of protecting farmers, but the practical application of these protections leaves much to be desired.

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114. *Id.*

115. *Id.*

116. 1,500 acres x \$560 tax liability per acre = \$840,000.

117. See generally *General Explanations of the Administration’s Fiscal Year 2022 Revenue Proposals*, *supra* note 55.

118. White House Fact Sheet, *supra* note 54.

119. USDA, *supra* note 75.

120. Buffie & Lord, *supra* note 61.

The short and simple sentence describing the protection fails to answer key questions that will certainly arise.<sup>121</sup> What does it mean for a farm to “stay in the family?” Does “family” only include blood-related relatives, or could those related by marriage also benefit from the protection? Does the family member have to be involved in the business at the time of death, or does the protection trigger if the heir steps into the business after death? What does that involvement look like? What if the farmland and other assets are held in a limited liability company (“LLC”) and then are transferred at the death of the owner to another LLC that is operated by a family member of the original owner? With these unanswered questions, farmers may feel restricted in their business decisions for fear of triggering tax liability, even if it was originally deferred.

## V. APPROACHING THE STEP-UP IN BASIS MOVING FORWARD.

The step-up in basis provision will be a resurging debate in years to come. Even though tax proposals from the House Ways and Means Committee and the Senate Finance Committee look drastically different from the original plans, some believe Congress is still willing to close the step-up in basis loophole in the future.<sup>122</sup> The road to closing the loophole, however, may be fraught with arguing and lobbying about the best way to achieve that goal.<sup>123</sup> “Lawmakers must resolve tricky design and implementation details that derailed past attempts to change how capital gains are treated when assets are passed from one generation to the next.”<sup>124</sup>

Implementation is difficult because the provision affects taxpayers across the board but in vastly different ways. Among Americans at large, the benefits of the step-up in basis loophole fall disproportionately to the wealthiest taxpayers, while low-income taxpayers rarely benefit. Since tax equality is a focal point of the Biden administration’s agenda, it makes sense that lawmakers have targeted this provision to close the gap between billionaires and the lower and middle classes. But the breadth of the consequences will not be isolated to the extraordinarily wealthy. Measures must be implemented that not only target billionaires but also protect average Americans, like farmers.

### A. *Preserve Step-up in Basis for Farm Assets to Agricultural Valuations.*

If the goal of the step-up in basis is indeed to “tax the rich,” then family farms and small businesses should be shielded from the provisions entirely. As the agriculture study from Texas A&M indicated, maintaining cash flow as a full-time

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121. Carmen Reineike, *Biden Says He’ll Protect Businesses From Certain Tax Hikes. It’s Not Clear How*, CNBC (Apr. 30, 2021, 10:45 AM), <https://www.cnbc.com/2021/04/30/its-unclear-how-biden-will-protect-some-businesses-from-tax-hikes.html>.

122. Benjamin Willis, *Is Repealing The Tax-Free Basis Step Up Really Dead?* FORBES (Sept. 29, 2021, 12:36 PM) <https://www.forbes.com/sites/taxnotes/2021/09/29/is-repealing-the-tax-free-basis-step-up-really-dead/?sh=40285d2134da>.

123. Garrett Watson, *History of Attempted Changes to Step-Up in Basis Shows Perilous Road Ahead*, TAX FOUNDATION (Oct. 24, 2021, 5:14 PM) <https://taxfoundation.org/biden-estate-tax-unrealized-capital-gains-at-death/>.

124. *Id.*

No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 183

farmer in the current economic climate is a difficult task.<sup>125</sup> Many farmers are running a negative cash balance with tax liability remaining at the status quo.<sup>126</sup> There is no scenario where increasing tax liability of full-time farmers helps the survival of farmers.

To accomplish the task of “taxing the rich”, tax laws should allow beneficiaries to take advantage of step-up in basis for farmland to the agricultural value of that land. Generally, the agricultural value of real estate is lower than the fair market value of real estate.<sup>127</sup> This would allow successor farmers to continue farming the land themselves or would encourage non-farming beneficiaries to sell the land back to farming beneficiaries. Non-farming beneficiaries could also cash rent or sell the land to other farmers in the community, maintaining the land for agricultural use.

In addition, farmers receiving land through an estate must have the freedom to manage that land effectively without fear of triggering tax liability. President Biden’s proposed tax changes included limiting the deferral of gains from like-kind exchanges to 500,000 dollars for individuals and one million dollars for a married couple.<sup>128</sup> Under Internal Revenue Code (IRC) Section 1031, farmers can sell a low-performing or smaller parcel of land in order to reinvest in a better parcel of land by electing for a 1031 exchange.<sup>129</sup> Under some propositions, this action would mean the land was leaving the family farm and would incur tax liability. But if farmers were already afforded a step-up in basis, they could make such a business move freely.

This full exemption would prevent unnecessary complexity that would certainly result from drafting effective protections for family farms. However, the challenges inherent in eliminating the step-up in basis, and failed attempts to change the law in the past, do not necessarily doom the prospect of closing the loophole entirely.<sup>130</sup> In order to change step-up in basis without crippling family farms and businesses, Congress would need to address these complexities with comprehensive protections.

#### A. *Protect the Right People by Focusing on the Right Assets*

Since the goal of eliminating step-up in basis is to tax the rich, the loophole should be eliminated for assets that are unique to the ultra-wealthy. Ultra-high net worth investors often invest a significant percentage of their portfolio in “alternative investments.”<sup>131</sup> Alternative investments are investments in anything other than listed equities, bonds, and currencies.<sup>132</sup> In 2020, investors with a net worth exceeding 30 million dollars had 50% of their investment portfolio in alternative investments.<sup>133</sup> Investors with over one billion dollars in assets chose alternative

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125. Joe L. Outlaw et al., *supra* note 83.

126. *Id.*

127. 26 U.S.C. § 2032.

128. Steven Marer, *Biden’s Tax Proposal to Limit IRS Section 1031 Exchanges*, KJK (July 23, 2021), <https://kjk.com/2021/07/23/bidens-tax-proposal-to-limit-irs-section-1031-exchanges/>.

129. *See* 26 U.S.C. § 1031(a)(1).

130. Watson, *supra* note 123.

131. Jack Caporal, *81% of Ultra-High-Net-Worth Individuals Use Alternative Investments*, THE MOTLEY FOOL (Aug. 18, 2021), <https://www.fool.com/research/high-net-worth-alternative-investments/>.

132. *Id.*

133. *Id.*

investments for more than 50% of their portfolio.<sup>134</sup> Average investors allocate only 5% of their investments to these alternative options.<sup>135</sup>

Private equity, real estate, and hedge funds are the most popular investments for the ultra-wealthy, but luxury goods like vintage cars, rare wine and whiskey, art, precious metals, baseball cards, and handbags are among these favored investments.<sup>136</sup> Time Magazine wrote an article entitled “Why the Hermès Birkin Bag is a Better Investment Than Gold,” which noted that the prestigious Birkin bag, a status symbol among the very wealthy, has outpaced the S&P 500 and the price of gold in the last 35 years.<sup>137</sup>

Lawmakers could eliminate step-up in basis and increase taxes for these types of alternative investments that are preferred by the wealthy. Doing so would reinforce the mantra that tax equality is about rewarding work and not wealth. Focusing on assets would also eliminate some of the ambiguity and complexity inherent in regulating taxes based on family dynamics. Current proposals cast a broad net of increased taxation and then try to protect the lower and middle classes with exemptions and protections. Instead, Congress should target tax increases toward the wealthiest taxpayers by focusing on the assets that they favor.

### B. Draft Effective Protections for Farmers

If lawmakers eliminate the step-up in basis, they must include clear protections that accurately address the nuances of full-time family farms. Furthermore, the protections should include higher exemption amounts to truly shield farmers from tax liability.<sup>138</sup> Congress may choose to pattern the language for the protections using existing tax law. For example, IRC § 2032A lays out the requirements for the valuation of certain farmland to the agricultural value, instead of the fair market value, if that land is passed to a “qualified heir” and used for a “qualified purpose.”<sup>139</sup> The definition of “qualified heir” is a member of the decedent’s family who acquired such property (or to whom such property passed) from the decedent.<sup>140</sup> Congress should expand that definition to give farmers more choice as they decide how to pass their assets to the next generation.<sup>141</sup>

Section 2032A could also give guidance for creating a path to a step-up in basis. If capital gains tax is deferred indefinitely, farmers may risk triggering immediate liability by failing to comply with vague or non-existent regulations. However, if Congress created a path to the step-up in basis of farm assets, farmers could plan a course of action in compliance with that path to attain a step-up in basis. Such a path might include using the farmland for farming purposes for a certain number of years.<sup>142</sup> It should also include guidance for non-farming heirs to avoid incurring tax liability by selling their shares back to a farming heir or for selling farmland

134. *Id.*

135. *Id.*

136. *Id.*

137. Tara John, *Why The Hermès Birkin Bag is a Better Investment Than Gold*, TIME (Jan. 15, 2016), <https://time.com/4182246/hermes-birkin-bag-investment-gold/>.

138. *Supra* Section III(B).

139. 26 U.S.C. § 2032A.

140. 26 U.S.C. § 2032A(e)(1).

141. *Est. of Cowser v. Comm’r.*, 736 F.2d 1168 (7th Cir. 1984) (finding a grandniece was not a qualified heir).

142. 26 U.S.C. § 2032A(b)(2).



No. 1] *Burckart: Saving Family Farms from Eliminated Step-Up in Basis* 185

back to a farmer for agricultural purposes instead of to a commercial developer.<sup>143</sup> These measures would maintain competition in the farmland market and reduce barriers for new young farmers to enter the profession.

## VI. CONCLUSION

Eliminating step-up in basis would deal a severe blow to the already strained agriculture industry. But when elimination of the step-up in basis gains momentum again, Congress must remember to protect full-time farmers from tax reforms meant for the extremely wealthy. Policies like allowing a step-up in basis for farm assets, creating broader and clearer protections for family farms, and forging a path to a step-up in basis of farm assets will maintain the freedom that farmers need to make good business decisions without fear of taxation.

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143. *Id.*